

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Roseville Telephone Company (U 1015 C) to Review Its New Regulatory Framework.

Application 99-03-025
(Filed March 8, 1999)

OPINION ADOPTING REVISED SETTLEMENT AGREEMENT**Summary**

By this decision, the Commission approves the Revised Settlement Agreement jointly submitted by SureWest Telephone (SureWest),¹ the Office of Ratepayer Advocates (ORA), and The Utility Reform Network (TURN), and adopts the accord as the basis for our order in this proceeding. Our order, like the Settlement Agreement, resolves all issues raised in SureWest's Petition for Modification (Petition) of its first New Regulatory Framework (NRF) triennial review order, Decision (D.) 01-06-077.

Background

On May 3, 2002, SureWest petitioned to modify D.01-06-077, its first NRF triennial review decision, seeking to eliminate the "sharing mechanism" that requires the company to allocate to ratepayers fifty percent of its annual earnings in excess of a "benchmark" rate of return (ROR) which is set higher than the

¹ SureWest formerly operated as Roseville Telephone Company.

Commission-adopted “authorized” ROR.² In its response, ORA opposed modification of the sharing mechanism. The assigned administrative law judge (ALJ) filed and served a draft decision denying the Petition in August 2003. An alternate draft decision, modifying the sharing mechanism as requested, was filed and served in October 2003. In November 2003, the assigned ALJ granted TURN leave to intervene. At the Commission’s February 26, 2004 meeting, both draft decisions were withdrawn from the agenda so that an evidentiary hearing could be quickly convened and a proposed decision promptly drafted. The Assigned Commissioner issued a ruling in March 2004 setting the matter for hearing.

SureWest served opening testimony on May 3, 2004. During the week of May 10, 2004, ORA conducted a limited on-site audit of SureWest’s books and accounting records for the years 2000-2003. SureWest and ORA subsequently reached agreement on certain accounting and ratemaking adjustments to SureWest’s records that were summarized in a letter from SureWest to ORA dated June 11, 2004. Attaching the SureWest letter, ORA submitted testimony addressing the remaining disputed audit issues and the future status of the company’s sharing mechanism on June 18, 2004.

² This is often referred to as the “50/50 Sharing Band.” SureWest also asked the Commission to eliminate the requirement that it share 100 percent of its earnings above the ceiling ROR with ratepayers, or at a minimum that the Commission replace this requirement with a 30/70 “reverse taper” sharing formula that would allow shareholders to keep seventy percent of all excess earnings above the ceiling ROR. Testimony of Greg Gierczak in Support of SureWest’s Petition for Modification of D.01-06-077 at 3 (May 3, 2004).

SureWest, ORA, and TURN, the active parties in this phase of the proceeding, began settlement discussions on June 29, 2004. On June 30, 2004, SureWest and ORA filed a Motion for an Expedited Order Adjusting Procedural Schedule to enable the parties to continue settlement discussions. The assigned ALJ held conference calls with SureWest and ORA, and modified the procedural schedule in a July 6, 2004 ruling.

On July 16, 2004, SureWest notified all parties of record, pursuant to Rule 51.1(b) of the Commission's Rules of Practice and Procedure (Rules), of a July 23, 2004 telephonic settlement conference to discuss the terms of the agreement. The settlement conference included SureWest, ORA, TURN, and a representative of Citizens Telecommunications Company of California, Inc. (Citizens).³ Citizens' representative neither signed nor opposed the Revised Settlement Agreement, a copy of which is appended to this order. On August 4, 2004, the assigned ALJ convened a brief prehearing conference in order to question the Settling Parties about various aspects of the agreement.

Summary of Revised Settlement Agreement

As a result of their negotiations, SureWest, ORA, and TURN settled all outstanding issues raised in the testimony in this proceeding. The components of the Revised Settlement Agreement are as follows:

- The parties agree on certain shareable earnings for SureWest for the years 2000-2004, and for the payment of certain consumer dividends (detailed below) to end-users. The parties agree that the shareable earnings amounts for those years will be deemed closed as part of this settlement.

³ Citizens has been inactive in this phase of the proceeding.

- In return, the sharing mechanism for SureWest, i.e., the “50/50 Sharing Band,” 100% sharing above the ceiling ROR, and the authority to seek an increase in rates or revenues because of a fall in earnings below the floor rate of return of 6.75%, shall be suspended beginning 1/1/2005 until at least 12/31/2010, after which time sharing will continue to be suspended unless reinstated or permanently eliminated by Commission order.
- As long as sharing is suspended, SureWest will pay a permanent yearly consumer dividend to end-users, and agrees not to seek an increase in intrastate rates to recover the permanent consumer dividend. In particular, before 1/1/2007, SureWest will not seek to increase intrastate rates without an equal reduction in other intrastate rates to offset the increase in rates.
- After 1/1/2007, the permanent surcredit can be offset by the amount of reduction, if any, in SureWest’s payment of \$11.5 million that is currently the subject of review in Application (A.) 01-04-026.
- SureWest shall file its next triennial NRF review no later than 90 days after a final decision in Rulemaking (R.) 01-09-001/ Investigation (I.) 01-09-002, or as specified in a further order of the Commission.
- The parties agree that SureWest’s service quality should not be a factor in resolving SureWest’s Petition for Modification. SureWest understands the decision of ORA and TURN to refrain from reviewing SureWest’s service quality in this proceeding should in no way limit the authority of ORA or TURN to fully review such service quality in subsequent NRF reviews.
- SureWest shall continue to report its actual yearly ROR on April 1 of each year, and such filing shall reference the market-based rate of return at 10%, benchmark 11.5%, ceiling at 15%, and the floor at 6.75%. Pursuant to the Revised Settlement Agreement, SureWest’s RORs for the years 2000-2003 are as

follows: 2000 – 12.86%; 2001 – 12.37%; 2002 – 13.88%; 2003 – 12.01%.⁴

- If the Commission rejects or modifies the terms of the settlement, the parties agree not to object to the preparation and service of rebuttal testimony by SureWest, and to the commencement of evidentiary hearings no sooner than ten calendar days after the service of such rebuttal testimony.

The Settling Parties detail the specific surcredits that are part of the settlement, and their method of distribution, as set forth below:

- In satisfaction of SureWest's shareable earnings obligation for earnings in the years 2000, 2001, 2002, and 2003, SureWest shall pay \$6.2 million plus interest to end-users. In satisfaction of its shareable earnings obligation for earnings in 2004, SureWest shall pay \$750,000 plus interest.
- The payment of \$6,950,000 described above, less the earnings of \$477,576 already shared per Commission Resolution T-16775, shall be returned to end-users through a consumer dividend⁵ over a period of four years beginning January 1, 2005 (or, in the event a Commission decision approving the Revised Settlement Agreement is not adopted until after January 1, 2005, beginning no later than two months following the Commission decision approving the Revised Settlement Agreement).
- SureWest shall also make an additional one-time payment of \$2.6 million in the form of a consumer dividend to end-users during the years 2005 and 2006. This additional one-time payment, in combination with the payments described above, constitutes the

⁴ See SureWest Comparison Exhibit Appended to this decision as Appendix I.

⁵ Consumer dividends, under the Revised Agreement, are surcredits applicable to the aggregate amount of recurring customer billings associated with all end-user services by SureWest.

full and complete satisfaction of SureWest's shareable earnings obligation relative to the years 2000-2004.

- Beginning January 1, 2007, SureWest shall implement a yearly consumer dividend in the amount of \$1.3 million (in addition to the consumer dividends referenced above). (The amount of this yearly consumer dividend can be reduced by the amount of reduction, if any, in SureWest's payment of \$11.5 million that is currently the subject of review in A.01-04-026.)

Discussion

Rule 51.1(e) provides that, prior to approval, the Commission must find a settlement "reasonable in light of the whole record, consistent with the law, and in the public interest." This agreement appears to meet each of the required criteria.

A survey of the testimony submitted in this proceeding reveals that the parties have taken very disparate positions. The Settling Parties declare that in reaching their accord they have compromised those positions by holding firm on some issues and deferring on others. (Revised Motion to Accept Settlement Agreement at 5.) The Revised Settlement Agreement enables SureWest to operate without sharing for at least six years (2005-2010), while providing a minimum of \$9.0 million (plus interest) in consumer dividends to be distributed during years 2005-2008, with the potential for an additional permanent yearly surcredit of \$1.3 million beginning in 2007.⁶ SureWest's end-users will receive these amounts through a consumer dividend based on all intrastate retail

⁶ The permanent yearly surcredit of \$1.3 million beginning on January 1, 2007 can be offset by the yearly amount of reduction, if any, of the \$11.5 million payment currently under review in A.01-04-026.

services, excluding switched and low speed special access services and other services normally excluded from surcredits.⁷ (*Id.*)

At the same time, the accord enables the Commission and the parties to reevaluate, in the future, the appropriate role of sharing. Under the agreement, the suspension of sharing could be modified after December 31, 2010. It also establishes the consumer dividends described above without addressing the merits of whether or not sharing is a relevant regulatory mechanism to retain. This allows the terms of the Revised Settlement Agreement to be implemented without chilling the ability of the parties to engage in advocacy prior to December 31, 2010, as long as any change in the sharing mechanism is not “implemented” until after that date. Thus, all parties have preserved their rights to present arguments to this Commission about suitable public policy outcomes in any future proceeding.

The parties also resolve audit issues raised in ORA’s testimony by reaching agreement on the RORs and shareable earnings for historical years 2000-2003 (including the payment of consumer dividends), and continue to require future ROR filings that comply with Commission policy. Attached to this order as Appendix I is a spreadsheet showing SureWest’s RORs for the years 2000-2003 reflecting the agreed-upon modifications to its results in light of ORA’s audit. The Revised Settlement Agreement ensures that SureWest will not raise rates to

⁷ Specifically, all non-recurring charges; all Carrier Switched and Special Access Services; voice mail services; pathfinder billing charges; foreign exchange out services; federal, state, and city taxes; billing adjustments; CPUC Reimbursement Fee Surcharge; California High Cost Fund-A Surcharge; California High Cost Fund-B Surcharge; California High Cost Fund-B Surcredit; California Teleconnect Fund; California Relay Service and Communications Fund Surcharge and the Payphone Provider Enforcement Surcharge.

recover the agreed-upon consumer dividends, but allows an offset to those consumer dividends if the Commission orders a decrease in SureWest's revenue requirement in pending matter A.01-04-026. Given these details, we find the Revised Agreement to be reasonable in light of the whole record.

The Settling Parties contend that while the Revised Settlement Agreement suspends the sharing mechanism, it provides end-users, through the consumer dividend, with tangible benefits that essentially mimic the suspended device. It replaces a “potential” reduction in the costs of services, under sharing, with a guarantee that end-users will pay less for their services. The Parties assert that the Revised Agreement not only provides SureWest with substantial operational certainty, but also complements the goals of NRF. The suspension of the sharing mechanism offers a strong profit-driven incentive for SureWest to manage its operations in the most efficient manner possible, and enables SureWest to respond to changes in market conditions through pricing flexibility.

Under the Revised Agreement, SureWest’s rates will continue to be set based on the NRF structure previously adopted for it; thus, rates will be just and reasonable pursuant to Pub. Util. Code § 451. The Revised Agreement appears consistent with the Commission’s policy regarding NRF, as set forth in D.89-10-031 and D.96-12-074. Therefore, we find the Revised Settlement Agreement to be consistent with applicable law.

The Joint Parties claim that the public interest supports adoption of the Revised Agreement. Through it, ratepayers receive a concrete benefit: the return of the guaranteed amount of \$9.0 million (plus interest) over a four-year period. Had this matter proceeded to hearing and a Commission determination, it is uncertain what amount the ratepayers would have received. Buttredding the financial benefits to ratepayers, the Revised Agreement does not permit SureWest a net rate increase for a period of two years. After two years, SureWest must follow the current procedures for seeking a rate increase, if any, and ORA and TURN have preserved their rights to object to any such proposed increase in intrastate rates.

In addition, beginning in 2007, end-users could pay \$1.3 million less annually for their intrastate services.⁸ Under the Revised Agreement, as long as sharing remains suspended, this potential additional consumer dividend will continue beyond 2010. The Joint Parties also declare that this accord provides certainty to ratepayers as well as to SureWest. For at least six years, there will be no question about the triggering of sharing or the necessity of refunds. SureWest's customers will pay less for most intrastate services: from 2005-2008, the Joint Parties estimate that the average customer bill will be reduced by more than \$100. For SureWest, the agreement offers the possibility of retaining earnings realized through its innovation and increased efficiency.

We concur that the Revised Agreement enables the parties and the Commission to avoid costly and resource-intensive litigation while still achieving significant results: (1) resolution of this case's issues in a manner acceptable to all the active parties in the proceeding; (2) reduction of SureWest's customers' intrastate service costs through the payment of consumer dividends; and (3) safeguards that ensure that the consumer dividends are not recovered through other rate increases while providing some economic certainty to SureWest. Since this comprehensive agreement offers benefits to each of the active parties as well as SureWest's ratepayers, we find it to be in the public interest.

In sum, we find the essential terms of the SureWest/ORR/TURN Revised Settlement Agreement to be reasonable, consistent with the law and in the public

⁸ The amount of this additional reduction, or consumer dividend, could be offset by the amount that the Commission reduces the \$11.5 million payment, if at all, in proceeding A.01-04-026.

interest. We adopt the Revised Agreement, and find that the accord resolves all the disputed issues raised in this proceeding.

Procedural Matters

On March 23, 1999, the Commission preliminarily categorized this matter as ratesetting and preliminarily determined that hearings would be required (Resolution ALJ 176-3012). Based on the record developed in this proceeding, we now conclude that hearings are not required and alter that preliminary determination.

Comments on Draft Decision

The Revised Agreement presents the Commission with an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Jacqueline A. Reed is the assigned ALJ in this proceeding.

Findings of Fact

1. On July 16, 2004, SureWest notified all parties of record, pursuant to Rule 51.1(b), of a July 23, 2004 telephonic settlement conference to discuss the terms of an agreement reached between all the active parties: SureWest, ORA, and TURN.
2. The assigned ALJ convened an August 4, 2004 conference so that the Settling Parties could clarify various terms of the agreement.
3. On August 31, 2004, the Settling Parties filed the revised accord with a Revised Motion to Accept Settlement Agreement.
4. The Revised Agreement includes all the terms of the accord.

5. A survey of the testimony submitted in this proceeding reveals that the parties have compromised very disparate positions by holding firm on some issues and deferring on others.

6. The Revised Agreement enables SureWest to operate without sharing for at least six years (2005-2010), while providing a minimum of \$9.0 million (plus interest) in consumer dividends to be distributed during years 2005-2008, with the potential for an additional permanent yearly surcredit of \$1.3 million beginning in 2007.

7. SureWest's end-users will receive a consumer dividend based on all intrastate retail services, excluding switched and low speed special access services and other services normally excluded from surcredits.

8. Under the agreement, the suspension of sharing could be modified after December 31, 2010.

9. The parties resolve audit issues raised in ORA's testimony by reaching agreement on the RORs and shareable earnings for historical years 2000-2003 (including the payment of consumer dividends), and continue to require future ROR filings that comply with Commission policy.

10. The Revised Settlement Agreement ensures that SureWest will not raise rates to recover the agreed-upon consumer dividends, but allows an offset to those consumer dividends if the Commission orders a decrease in SureWest's revenue requirement in pending matter A.01-04-026.

11. The Revised Agreement not only provides SureWest with substantial operational certainty, but also complements the goals of NRF.

12. The suspension of the sharing mechanism offers a strong profit-driven incentive for SureWest to manage its operations in the most efficient manner

possible, and enables SureWest to respond to changes in market conditions through pricing flexibility.

13. Under the Revised Agreement, ratepayers receive the return of the guaranteed amount of \$9.0 million (plus interest) over a four-year period.

14. The Revised Agreement does not permit SureWest a net rate increase for a period of two years.

15. After two years, SureWest must follow the current procedures for seeking a rate increase, if any, and ORA and TURN have preserved their rights to object to any such proposed increase in intrastate rates.

16. Beginning in 2007, depending on the outcome of A.01-04-026, SureWest customers could pay \$1.3 million less annually for their intrastate services.

17. As long as sharing remains suspended, the potential additional consumer dividend will continue beyond 2010.

18. This accord provides certainty to ratepayers as well as to SureWest.

19. The Revised Agreement enables the parties and the Commission to avoid costly and resource-intensive litigation while still achieving significant results.

Conclusions of Law

1. Pursuant to Rule 51.1(e), the Commission should apply the standard of review appropriate for settlements.

2. The essential terms of the Revised Settlement Agreement of SureWest, ORA, and TURN are reasonable, consistent with the law and in the public interest.

3. The Commission should grant the joint motion to accept the essential terms of the settlement, and adopt the agreement in resolution of all issues raised in SureWest's Petition to Modify D.01-06-077.

4. Evidentiary hearings are not required and the preliminary determination that hearings were required in this proceeding is now changed.

5. So that SureWest can file a compliance advice letter to implement the consumer dividends covered by the settlement agreement on its existing tariffs/surcredits, this order should be effective on the date it is signed.

O R D E R

IT IS ORDERED that:

1. The Revised Motion to Accept Settlement Agreement submitted by SureWest Telephone (SureWest), the Office of Ratepayer Advocates, and The Utility Reform Network is granted.

2. The essential terms of the accord, as set forth in the Appendix to this Order entitled “Revised Settlement Agreement,” are adopted in resolution of the issues raised by SureWest’s Petition to Modify Decision 01-06-077.

3. This is a final determination that evidentiary hearings are not required in this proceeding.

4. SureWest shall file compliance advice letters as necessary to adjust its tariffs/surcredits to flow through the consumer dividends covered by the “Revised Settlement Agreement” and adopted by this decision.

5. Application 99-03-025 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

APPENDIX I

Attachment B

Comparison Exhibit
SureWest Telephone "As Filed" to "Settlement Agreement"

	2000		2001		2002		2003	
	<u>As Filed</u>	<u>Settlement Agreement</u>	<u>As Filed</u>	<u>Settlement Agreement</u>	<u>As Filed</u>	<u>Settlement Agreement</u>	<u>As Filed</u>	<u>Settlement Agreement</u>
Rate of Return	11.26%	12.86%	10.37%	12.37%	11.87%	13.88%	12.15%	12.01%
Consumer Dividend	\$0	\$1.6 million	\$0	\$1.1 million	\$0.5 million	\$2.8 million	\$0.8 million	\$0.6 million

(END OF APPENDIX I)